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COMPARISON OF SEVEN FUNDAMENTAL FEATURES OF THE STATEMENT  
OF CHANGES IN FINANCIAL POSITION IN THE UNITED STATES,  
CANADA, THE UNITED KINGDOM, NEW ZEALAND AND AUSTRALIA

The University of Nebraska - Lincoln

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OF CHANGES IN FINANCIAL POSITION IN THE UNITED  
STATES, CANADA, THE UNITED KINGDOM,  
NEW ZEALAND AND AUSTRALIA

by

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The Graduate College in the University of Nebraska  
In Partial Fulfillment of Requirements  
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**TITLE**

Comparison of Seven Fundamental Features of the Statement of  
Changes in Financial Position in the United States,  
Canada, the United Kingdom, New Zealand and  
Australia

**BY**

Jerome J. DeRidder

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PREVIEW

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## CHAPTER I

### INTRODUCTION

A major objective of financial reporting is to supply relevant information to statement users for decision making purposes. Whether or not accounting fulfills this objective may be examined by attempting to answer the following questions: (1) who is the user of the information and for what purpose is the information to be used? (2) how much information is needed?<sup>1</sup>

Among the most widely accepted answers to the above questions are: (1) financial reports are prepared for the use of present and potential investors, creditors and other users in making rational investment, credit and similar decisions, and (2) "...accounting reports should disclose that which is necessary to make them not misleading."<sup>2</sup>

Historically, financial statements developed in response to the need to provide information to outside interest groups concerning the impact of management on the income

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<sup>1</sup>Eldon S. Hendriksen, Accounting Theory, (3rd ed.: Homewood, Illinois: Richard D. Irwin, Inc., 1977), p. 545.

<sup>2</sup>Maurice Moonitz, "The Basic Postulates of Accounting," Accounting Research Study No. 1 (New York: American Institute of Certified Public Accountants, 1961), p. 50.

stream. The basic financial statements are (1) the balance sheet, (2) the income statement, (3) the statement of changes in financial position, and (4) the statement of changes in owners' or stockholders' equity.

Many simplified descriptions of the balance sheet include the idea that it provides a financial picture of an organization at a specific point in time. In essence it reflects in one half the resources obtained from various sources such as payables, bonds, common stocks, and in the other half reports the amount of those resources that have been invested in the various classes of assets such as receivables, inventories, and equipment. The statement reflects aggregates up until a particular moment of time--it does not show transaction details.<sup>3</sup>

When comparative balance sheets showing the balances at the beginning and end of the period are presented, the

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<sup>3</sup>APB Statement No. 4 describes a balance sheet as a statement that presents the financial position of an enterprise at a particular point in time. Financial position comprises the enterprises assets, liabilities, owners' equity and the relationship among them, including other financial matters related to the enterprise at the time which are required to be disclosed in conformity with general accepted accounting principles. See American Institute of Certified Public Accountants, APB Statement No. 4, reprinted in Financial Accounting Standards (Chicago: Commerce Clearing House, 1976), pp. 442 and 462. For a more complete definition see Eric Kohler, A Dictionary for Accountants (Engle: Prentice Hall Inc., 1970), p. 47.



statement users can reconstruct some of the details; however, they cannot ordinarily identify whether changes in assets and liabilities resulted from profitable operations, new equity, or from using assets to pay debts, acquire other assets or make distributions.

Some detail about the amount of resources generated from operations each fiscal period is reflected in the statement of owner's equity (or retained earnings statement) and the income statement. The statement of owner's equity presents net income and items such as dividends and adjustments of the net income of prior periods.<sup>4</sup> The income statement presents the results of the firm's profit directed activities for the period in terms of revenue, expenses, gains and losses in conformity with generally accepted accounting principles.<sup>5</sup> However, neither the balance sheet, the income statement, nor the statement of changes in the owners' or stockholders' equity show in detail the significant transactions which were entered into during the period to finance the firm.

For many years accountants were aware that the balance

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<sup>4</sup>APB Statement No. 4, Commerce Clearing House, p. 442.

<sup>5</sup>Ibid. p. 442 and 463. For more information see Kohler, A Dictionary for Accountants, p. 226.

sheet, income and retained earnings statements and the statement of changes in stockholders' equity did not provide statement users with all of the relevant facts desired for efficient decision making. A statement specifically designed to provide information concerning the source and utilization of resources came to be included as part of the financial reports of many firms on an optional basis. It was prepared in a variety of slightly different forms under many different names, including the following:

1. Statement of sources and application of funds
2. Funds flow or funds statement
3. Statement of funds provided and applied.

Prior to Accounting Principles Board Opinion No. 19 (APB Opinion 19), the preparation of a funds statement was recommended by Accounting Principles Board Opinion No. 3 but it was not required by official promulgation or government edict. It simply evolved in response to the need of investors and other statement users. During this evolutionary process, the term "funds" has been used in many ways, including the following:

1. Working capital
2. Quick assets less current liabilities
3. Cash and marketable securities less current liabilities
4. Cash and marketable securities less short-term bank credit

5. Cash and marketable securities
6. Cash
7. Total funds employed in the business
8. Total shareholders' funds
9. Equity interests.<sup>6</sup>

Although not identified as another concept of funds, preparation of supplemental statements restated for general price changes under Accounting Principles Board Statement No. 3 and Financial Accounting Standard No. 33 start with preparation of a funds statement using a net monetary assets concept of funds.

In 1971 the Accounting Principles Board (APB) changed the recommendation for the preparation of a funds statement to a requirement that a funds statement must be included as part of the annual financial statements whenever a balance sheet and an income statement is prepared. The APB obviously assumed that the inclusion of such a statement would provide relevant information to decision makers. In the introduction to the opinion, they noted that:

In view of the present widespread recognition of the usefulness of information on sources and uses of funds, the Board has considered whether presentation of such a statement should be required

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<sup>6</sup>Accountants International Study Group, The Funds Statement: Current Practices in Canada, United Kingdom, and the United States (New York: American Institute of Certified Public Accountants, 1973), para. 33.

to complement the income statement and the balance sheet.<sup>7</sup>

The first paragraph of the opinion proper builds from the usefulness assumption with these words:

The Board concludes that information concerning the financing and investing activities of a business enterprise and the changes in its financial position for a period is essential for financial statement users, particularly owners and creditors, in making economic decisions. When financial statements purporting to present both financial position (balance sheet) and results of operations (statement of income and retained earnings) are issued, a statement summarizing changes in financial position should also be presented as a basic financial statement for each period for which an income statement is presented. These conclusions apply to all profit-oriented business entities, whether or not the reporting entity normally classifies its assets and liabilities as current and noncurrent.<sup>8</sup>

An all financial resources concept is required. Under this concept the enterprise may adopt whatever concept of funds it believes most useful. The financial and investing effect of all financial transactions which have an impact on the firm's financial position must be disclosed separately regardless of which concept is followed, even if cash or working capital is not directly affected.

The Board has provided the following guidelines for

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<sup>7</sup>Accounting Principles Board Opinion No. 19, "Reporting Changes in Financial Position" (New York: American Institute of Certified Public Accountants, 1971), para. 2.

<sup>8</sup>Ibid. para. 7.

presenting the funds statement:

1. The statement should set out working capital or cash provided by or used in operations
2. Results of operations should exclude the effects of extraordinary items
3. Net changes in each element of working capital should be disclosed in detail
4. The effects of other individual financing and investing activities should be separately disclosed
5. The statement should also clearly disclose
  - a) Outlays for the purchase of long-term assets
  - b) Proceeds from the sale of long-term assets not used in the business, less related expenses
  - c) Conversion of long-term debt or preferred stock to common stock
  - d) Issuance, redemption, or purchase of capital stock
  - e) Issuance, assumption, redemption, and repayment of long-term debt
  - f) Dividends in cash or in kind or other distributions to shareholders (except stock dividends and stock splits)
6. Isolated figures of cash or working capital provided by operations should not be presented in the annual

stockholders' reports.<sup>9</sup>

In order to reflect the broad concept indicated in the above guidelines, the Board recommended that the title of the statement be changed to Statement of Changes in Financial Position.

The following section reviews the literature search for this study and the need for an international study of the statement of changes in financial position in selected foreign countries is identified. The objective of the study is discussed along with the methodology used, research design, historical research, empirical research and anticipated evaluation of findings.

#### Literature Review

A review of the literature concerning the statement of changes in financial position shows that a considerable amount of research has been done on the development of a "funds" statement. Areas covered by previous studies include:

- (1) The importance of the statement of changes in financial position to various users of the

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<sup>9</sup>Ibid. para. 10-15.

statement<sup>10</sup>

- (2) The most useful definition of "funds" and format presentation to be used in reporting information within the statement<sup>11</sup>

- (3) Compliance of the United States companies preparation of the statement of changes in financial

<sup>10</sup>E. L. Summers, "Observation of Effects of Using Alternative Reporting Practices." The Accounting Law Review (April 1968), pp. 257-268; Lyn D. Pankoff and Robert Virgil, "Some Preliminary Findings from a Laboratory Experiment on the Usefulness of Financial Accounting Information to Security Analysts," Empirical Research in Accounting: Selected Studies 1970, supplement to Journal of Accounting Research (1970), pp. 1-48; Gyan Chandra, "A Study of the Consensus on Disclosure Among Public Accountants and Security Analysts," The Accounting Review (October 1974), pp. 733-742.

<sup>11</sup>Philip E. Fess and Jerry Weygandt, "Cash Flow Presentations--Trends, Recommendations," Journal of Accountancy (August 1969), pp. 52-59; John H. Regazzi, "Why Aren't Financial Statements Understood?" Journal of Accountancy (April 1974), pp. 48-55; Maurice Stark, "Funds--Working Capital or Cash?" Michigan CPA (May-June 1975), pp. 23-25; Robert L. Warren and Jackson White, "Cash Information: Toward a More Useful Statement of Changes in Financial Position," The National Public Accountant (February 1975), pp. 30-34; Ganas K. Rakes and William Shenkir, "User Responses to Accounting Principles Board Opinion No. 19," Journal of Accountancy (September 1972), pp. 48-55; S. C. Yu, "A Flow of Resources Statement for Business Enterprises," The Accounting Review (July 1969), pp. 571-582; Aubrey C. Roberts and David Gabhart, "Statement of Funds: A Glimpse of the Future?" Journal of Accountancy (April 1972), pp. 49-54; Evan J. Henry, "A New Funds Statement Format for Greater Disclosure," Journal of Accountancy (April 1975), pp. 56-62; Study Group on the Objectives of Financial Statements, Objectives of Financial Statements (New York: American Institute of Certified Public Accountants, 1973), pp. 20-37.

position with the provisions set out in APB Opinion 19.<sup>12</sup>

A review was made of dissertation studies concerning the "funds" statement.<sup>13</sup> Also, research of the various professional accounting organizations involving the "funds" statement was examined.<sup>14</sup> Although a thorough search was made of the many studies involving various aspects of the

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<sup>12</sup>Earl A. Spiller and Robert Virgil, "Effectiveness of APB Opinion No. 19 in Improving Funds Reporting," Journal of Accounting Research (Spring 1974), pp. 112.

<sup>13</sup>Jack J. Kempber, "The Statement of Application of Funds in Modern Corporate Accounting Practice," (Ph.D. dissertation, University of California, Los Angeles, 1968); Edward J. Schmidlein, "The Funds Statement in Accounting Practice and College Instruction, (Ph.D. dissertation, New York University, 1953); Robert L. Kvam, "A New Funds Statement: A Statement Summarizing Financial Transactions," (Ph. D. dissertation, Louisiana State University, 1957); Lawrence S. Rosen, "A Critical Examination of Funds Statement Concepts," (Ph.D. dissertation, University of Washington, 1966); Earl R. Brownlee II, "An Investigation and Analysis of the Usefulness of the Statement of Changes in Financial Position to Selected Users of Corporate Financial Information," (Ph. D. dissertation, Georgia State University, 1975); Howard M. Daniels, "A Reformulation of the Theory of the Funds Statement," (Ph.D. dissertation, University of Texas, 1957).

<sup>14</sup>American Accounting Association's Subcommittee on Financial Accounting Standards, "Response to Exposure Draft Number 7 of the International Accounting Standards Committee entitled, 'Statement of Source and Application of Funds,'" reprinted in the Accounting Review (Supplement to Vol 52, 1977), p. 192-199; "Objectives of Financial Reporting by Business Enterprises," Statement of Financial Accounting Concepts No. 1 (Stamford, Connecticut: Financial Accounting Standards Board, 1978), p. viii.